HEUBLEIN 1976 ANNUAL REPORT

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Dividends Declared & Stock Price Ranges

			Stock Price Range*	
	Quarter	Dividend	High	Low
1976	4	$.30	56½	46⅞
	3	.30	59¾	46½
	2	.30	48	39⅛
	1	.275	50½	37½
1975	4	$.275	46¾	34¾
	3	.275	40	20½
	2	.275	28½	17¾
	1	.25	43½	19½

*New York Stock Exchange

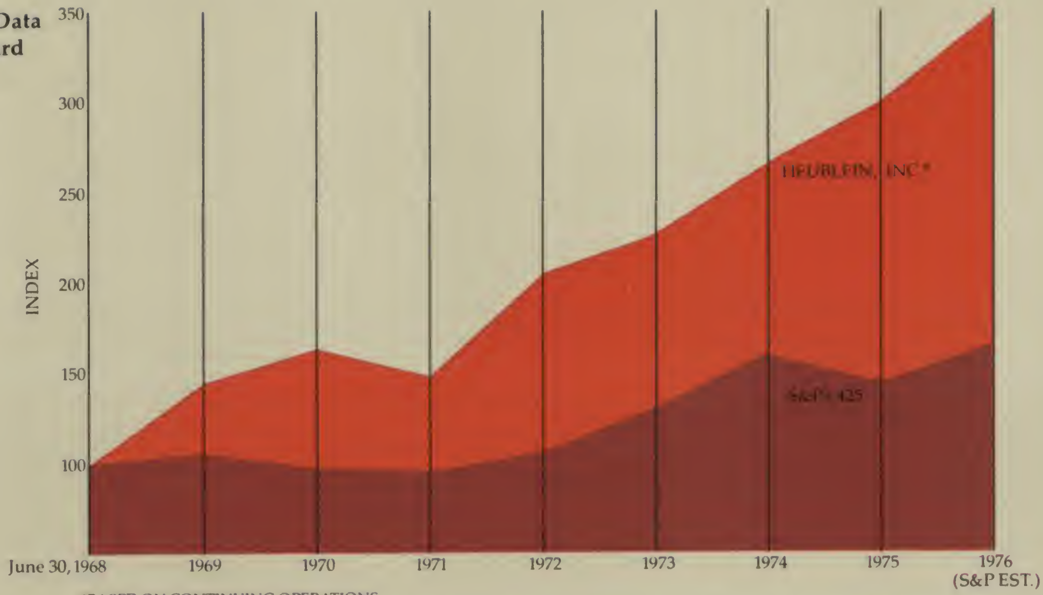
Annual Shareholders' Meeting

The annual meeting of shareholders of Heublein, Inc. will be held at 10:00 a.m. Thursday, October 28, 1976, in the Grand Ballroom of the Sheraton-Hartford Hotel, Trumbull Street at Civic Center Plaza, Hartford, Connecticut.

Underlying Heublein's record results in fiscal 1976 is an interesting marketing phenomenon. ☐ *Today's market is dominated by the fast-growing group of 25-44 year-old consumers, young adults committed to an active, expressive new life-style–and to using products that enhance it.* ☐ *Because Heublein's products have the new values that consumers want, many of its brands sold at a record pace in 1976.* ☐ *As today's consumers perceive it, Kentucky Fried Chicken offers not only good taste, but true, time-saving convenience and fun. Smirnoff gives the assurance of the top-of-the-line brand. Harveys Bristol Cream is unmatched elegance. And A.1. Steak Sauce is added zest to almost any dish.* ☐ *And as the pictures on the following pages show, what the consumer wants for many occasions is what the consumer gets in products from Heublein.*

Earnings Per Share Data Heublein vs. Standard & Poors' 425 Stocks

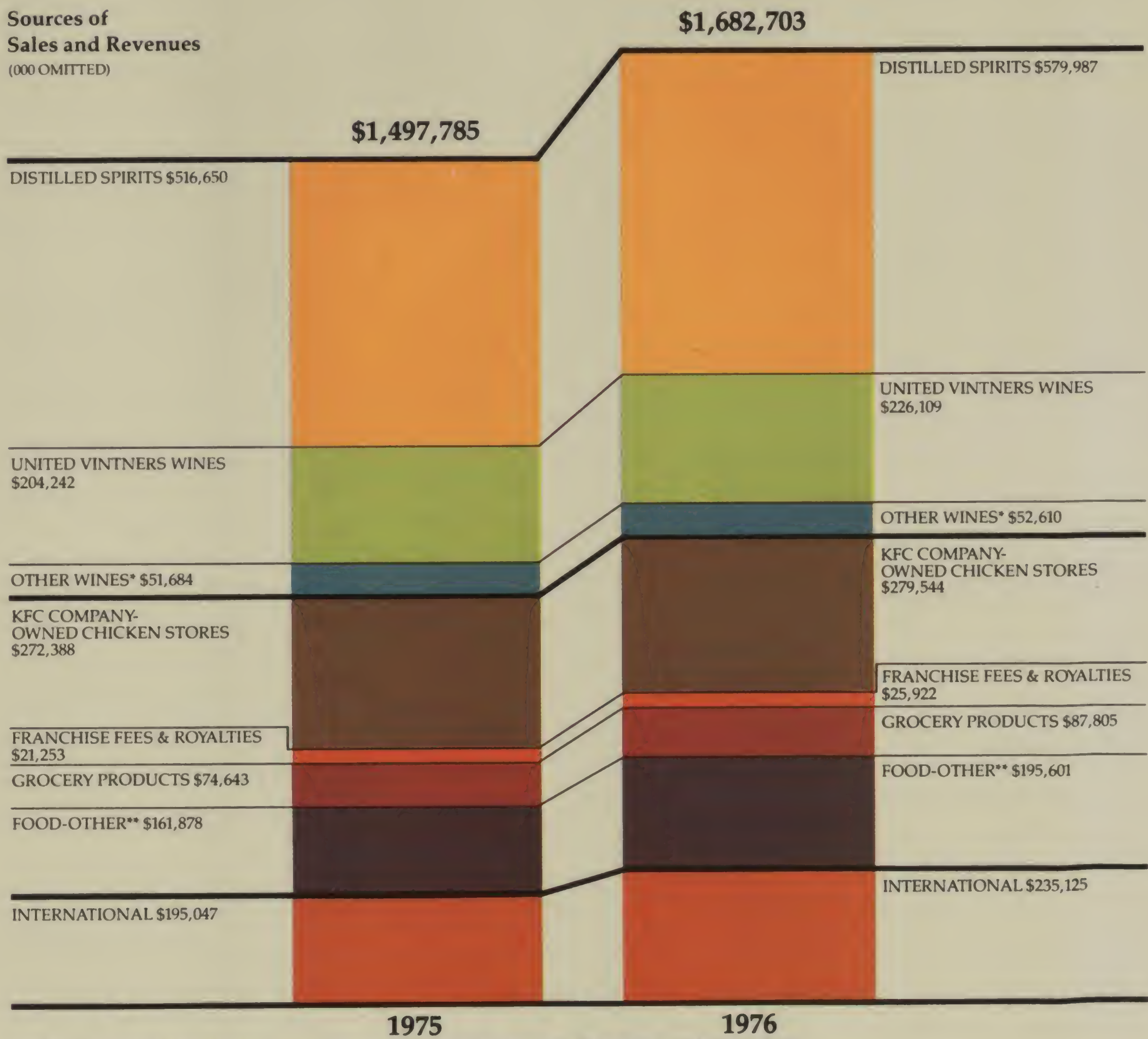
1968 equals 100



*BASED ON CONTINUING OPERATIONS

This chart compares the growth of Heublein's earnings per share since 1968 to average earnings of the 425 U.S. companies comprising the Standard & Poors' Index. Both in consistency and rate of growth, Heublein has outperformed the average of the companies in the S&P Index.

Sources of Sales and Revenues
(000 OMITTED)



*IMPORTS AND BEAULIEU VINEYARD **PRIMARILY POULTRY AND STORE EQUIPMENT AND SUPPLIES

Heublein

Financial Highlights

Year Ended June 30	1976	1975	Percent Increase
FOR THE YEAR:			
Revenues	**$1,682,703,000**	**$1,497,785,000**	**12%**
Income before federal, state and foreign income taxes	144,026,000	123,610,000	17
Income taxes	70,933,000	62,114,000	14
Net income	**73,093,000**	**61,496,000**	**19**
Earnings per share:			
Primary	3.39	2.90	17
Fully diluted	3.27	2.79	17
Cash dividends declared per common share	1.175	1.075	9
AT JUNE 30:			
Working Capital	230,344,000	219,535,000	
Shareholders' equity	372,902,000	324,568,000	
Shareholders' equity — per common share	17.54	15.24	
Number of common shareholders	24,769	27,174	

Letter to Shareholders

In fiscal 1976 a confident new thrust was evident in our company and the record results show it.

The year began amid first signs that the U. S. economy was on the road to recovery. While many companies were still trying to reverse a downward trend, Heublein, coming off a record year, was targeting for higher goals.

We were stronger than ever in the fast-growing segments of the food and beverage industries. We had set new goals for every major part of our business, based on a broadened use of strategic planning. We had seasoned management in place in all our operating units. These strengths, and a great effort by our management team, produced the outstanding results highlighted on the preceding page.

Even before signs of recovery appeared, our business was doing well and we were confident that the impetus for a turnaround would come from the consumer. We were convinced that, when the consumer came back in strength to buy, it would be with new values and new priorities reflecting the changing American lifestyle.

We backed our belief by introducing more new products with emphasis on values, by setting new price patterns and by intensifying our marketing with record expenditures for advertising, merchandising and promotion.

When the turnaround came it was just about as we had expected and planned.

All the real growth in the U.S. spirits industry occurred in non-whiskies — vodka, rum, tequila, cocktails and cordials — areas where we are strongest.

Vodka was the fastest-growing of all major spirits and Smirnoff was the leading brand by a substantial margin.

It was a see-saw year for wines, but wherever there was value the consumer responded. While import sales sagged in the first half, they were very strong in the second half. Harvey s Bristol Cream sherry proved an exception, climbing steadily in sales and profits, but sales of our Lancers brand were off for the year.

Our California wines were in line with the trend in that market — up at a rapid pace in the first six months, but increasing at a slower pace the rest of the year. With new products, new values and aggressive marketing both Beaulieu Vineyard and United Vintners had record years. For the fourth consecutive year, U.V. increased its share of the U.S. wine business. Its dry table wines, representing the bulk of its business, outperformed the market, but its sweet wines declined.

Heublein was stronger than ever in the fast-growing segments of the food and beverage industries.

Five new varietal wines, introduced with the "Colony" label of Italian Swiss Colony, proved widely popular and made a major contribution to U.V.'s performance.

Like light wines and light spirits, a number of lifestyle products sold at record levels right through the recession, making a convincing point. The masses of young adults in America's market put a value on taste and convenience that supersedes price.

It was this developing trend that increased the number of meals consumed outside the home last year and boosted sales of specialty foods used to enhance good taste.

In the widening spectrum of consumer tastes, Mexican foods are one of the most exciting and popular trends in the market today. As consumption grows so do sales of our Ortega brand. And with the start-up of our modern food plant in Oxnard, California, we are in a position to double our Ortega production as demand warrants it.

We also have an expanding Mexican-American restaurant chain under the name Zantigo.

Our quick service restaurant business had a net gain of 125 new outlets last year. Most were chicken stores, but a number were Zantigo restaurants and H. Salt Seafood Galleys. Others will be added in the years just ahead.

Even though most foreign countries lagged behind the United States in recovering from the recession and some countries had minor currency devaluations, our international business was very good.

Smirnoff grew overseas at twice the rate it did in the U.S., securing its position as the No. 1 spirit brand internationally.

Similarly, KFC, the world's largest U.S.-based quick service restaurant chain, added more stores last year and expanded into more countries.

In Brazil, where Heublein operates the largest distillery south of the equator and has a majority position in the whisky market, the government increased spirit taxes, causing retail prices to double. Even with that, our 20 brands had increased sales.

Heublein's performance depends, to a large degree, on the quality of its people. There are some 25,000 Heublein people serving in more than 100 countries and their talents and skills are of the highest caliber. To attract and retain them we have regularly introduced new programs and improved existing ones to provide the best in training, in benefits, in compensation and in career development.

During the past fiscal year we moved more women and minorities into management positions, enhancing our company's strength and balance at this level.

In the area of corporate public affairs, we widened our efforts to help curb and prevent alcoholism and alcohol abuse and supported selected educational, health and social programs in our plant communities.

Chiefly as a result of Federal Government research and aid, many states now officially recognize alcoholism as a disease that can be treated and not a criminal offense. To support this encouraging trend, which is in sharp contrast to the past, Heublein has joined with the National Council on Alcoholism and the Medical School of New York University to help train physicians in the proper care of the alcoholic. As evidence of the program's acceptance, part of the funds comes from tuition paid by participating physicians.

Financially, your company gained strength last year. We increased our assets, lowered the debt-to-total-capital ratio and increased the return on shareholders equity to 21 per cent.

Our capital expansion, principally the new food plant at Oxnard, California, and a new, $26-million spirits plant, under construction at Paducah, Kentucky, is being financed principally from internally-generated funds.

Looking ahead, we expect the economy to continue to improve. As it does, the number of higher-income families will increase. More dollars will be spent to assure the kind of lifestyle that consumers want and one that Heublein products serve so well.

In many ways, your company is in the strongest position ever to capitalize on this future. It has made marked progress in strategic planning, enabling management to analyze opportunities with greater precision and to apply our resources to only the very best of them.

These assets and accomplishments are the foundation for our confidence that fiscal 1977 will be another highly successful year.

Hicks B. Waldron

Hicks B. Waldron
President & Chief Executive Officer

Stuart D. Watson

Stuart D. Watson
Chairman of the Board


SMIRNOFF
VODKA
FL 4238 CV

Beverage Operations

America's move toward light and flavorful drinks, which a decade ago was regarded as only a temporary departure from the mainstream of consumer taste preference, is now the mainstream itself.

This rapidly expanding shift in consumption patterns was reinforced in fiscal year 1976. As the U.S. economy recovered, total case volume of the distilled spirits industry increased only modestly. More significant, however, was the far greater growth that occurred in those segments of the industry in which Heublein operates.

Industry-wide spirits case sales were up slightly more than one per cent for the year. Yet when basic whiskey products — Bourbon, blends and Scotch — are excluded, the remaining segments, comprised primarily of Canadian whisky, vodka, rum, tequila, prepared cocktails and cordials, showed an estimated growth rate of six per cent.

Heublein products . . . accounted for more than half the growth of the spirits industry in fiscal 1976.

Heublein products, well-positioned in this fast-growing segment, accounted for more than half the entire growth of the spirits industry in fiscal 1976.

U.S.-produced wines continued their strong performance and finished the year up by an estimated six and one-half per cent. Experiencing even greater growth, United Vintners Inc., Heublein's California wine company, increased its position in the U.S. wine business for the fourth consecutive year.

Sales and revenues from Heublein's beverage operations, including both the Spirits Group headquartered in Hartford and the Wines Group based in San Francisco, totaled $859 million, an 11 per cent increase over a year ago. Operating income increased 15 per cent to $73 million.

Despite operating in a business environment marked by intensified competitive activity directed at the non-whiskey categories, Heublein's Spirits Group not only increased its spirits case sales volume by more than nine per cent, but also gained in its overall share of the spirits business.

The attractiveness of the non-whiskey segment of the spirits business — reflecting more than four times the growth rate of the total industry this year — was underscored by the fact that these types of products now represent nearly half of all liquor sold in the U.S. Just ten years ago, they accounted for less than one third of the total market.

Vodka solidified its position as the nation's No. 1-selling spirit during the year as this category grew by seven per cent, compared to a decline among the former long-time spirits leaders, Bourbons, blends and Scotch.

United Vintners increased its position in the U.S. wine business for the fourth consecutive year.

Smirnoff, the nation's leading vodka brand and the flagship label in Heublein's spirits line, increased its


SUNRISE

sales by more than eight per cent to six million-plus cases. In doing so, Smirnoff added to its share of the 27-million case U.S. vodka business.

Smirnoff grew at an even faster pace in the second half of the year, despite stepped-up marketing and sales thrusts by competitors.

Popov and Relska, the other two major Heublein vodka brands, yielded some case volume growth because of price increases, but added to their overall profitability.

Canadian whisky was alone among all whiskey categories to demonstrate any growth for the year. This category was up slightly more than three per cent. Heublein's main entry, Black Velvet Canadian, increased its case shipments almost four times the industry rate. In fact, Black Velvet accounted for 29 per cent of the growth of the Canadian whisky category in the U.S.

Arrow Cordials, which expanded its line with the addition of two new drinks — Amaretto and Creme de Strawberry — increased its sales significantly and passed the one-million case mark for the first time. It thus joined Smirnoff, Black Velvet, Popov, Relska and The Club Cocktails in the Heublein million-case club.

A new Heublein brand, Malcolm Hereford's Cows, established itself as the sales phenomenon of the industry. These light, milk-like, 30-proof bottled drinks achieved unprecedented sales levels for a new spirits product in their first year on the market. By year's end, they were being shipped at an annualized rate of better than a million cases. Achieving immediate popularity with nearly all segments of the adult population, Hereford's Cows were marketed in four flavors, strawberry, mocha, banana and chocolate mint. A fifth flavor, coconut, was added after the initial introduction.

Jose Cuervo (white) and Cuervo Especial (gold), the company's premium entries in the tequila category, maintained Cuervo's position as the No. 1-seller nationally.

The Club Cocktails in cans, unchallenged as the leader in this segment of the market, expanded case sales by more than nine per cent and, toward the end of the year, embraced another new drink, The Strawberry Margarita. Heublein Full-Strength Bottled Cocktails, rebounding from a slight sales downturn a year ago, also registered a healthy sales gain of seven per cent. Two new drinks were added to the line just before year's end, the classic Grasshopper and Brandy

Alexander. Early indications were that these new drinks were sparking new consumer interest in the entire, 19-flavor Heublein Cocktail line.

While the Spirits Group moved to expand and upgrade its production capacity on several fronts, the most significant development was the announcement, just before the close of the fiscal year, that Heublein will build a $26-million spirits plant at Paducah, Kentucky. This new plant is now under construction and is expected to be ready for production early in calendar year 1978. Ultimately, it will have the capacity to increase the company's over-all liquor production by 40 per cent.

Heublein's wine operations moved parallel to the successful performance of the company's spirits business for the year.

United Vintners achieved another record year of sales in fiscal 1976. Marching in concert with rapidly-changing consumer buying patterns, United Vintners built on its earlier successes with a combination of new product introductions, improved marketing concepts, and line extensions of well-established brands.

Although there was considerable progress in all sectors of its business, a principal achievement at United Vintners was the highly successful introduction of a new line of varietal wines under the Colony label. The Colony varietals, marketed in screw-cap bottles, met with wide-spread consumer acceptance.

Inglenook, one of the most prestigious of California wines, continued its sales growth spurred by the broad-based success of its moderately-priced Navalle line of varietals. In the refreshment wine category, United Vintners' two major entries, T. J. Swann and Annie Green Springs, reinforced their market leadership and increased sales volume by more than 20 per cent. Reflecting the increasing consumer demand for light, dry table wines, the company's line of sweet wines experienced a sales decline for the year.

The scene at left is the opening night reception for "Cows," a unique exhibit of art with a bovine theme staged this summer by the Queens (N.Y.) Museum. More than 800 guests attended the opening, and the beverage they enjoyed, naturally, was Malcolm Hereford's Cows, Heublein's highly successful new brand of light, milk-like drinks.

Three new products, each with a slightly lower alcohol content than most table wines, were moved into distribution by United Vintners late in the year. Each aimed at a particular market segment, these new products were Jacare, a fine wine to be served over ice; HMS Frost, beverage wine, and Esprit, a white wine with a hint of lime. Preliminary market readings were positive on all three.

The other component of our California wine business, Beaulieu Vineyard estate-bottled wines, experienced a strong year and increased sales of virtually all premium brands. In addition, Beaulieu introduced two new moderately-priced varietals — Beau Tour Cabernet Sauvignon and Beau Velours Pinot Noir — which met with almost instant success.

Industry sales of imported wines bounced back from a modest sales decline in the first half as overstocked inventories were worked off and by year's end were moving ahead again at a healthy rate.

Heublein's imported wines had a good year over-all, especially Harveys Bristol Cream sherry. The company's other major premium wine import, Lancers, shared in the downturn of demand for Portuguese wines during the year.

Food Operations

Food is a $185 billion-plus industry in the U.S. and in those major sectors where Heublein operates, fiscal year 1976 was marked by steady, if not superior growth.

1976 was a year of continuing growth . . . and important new directions for Heublein's food operations.

Quick service restaurants accounted for 30 per cent of the $40 billion that Americans spent in public eating places and Heublein's representative in this fast-growing segment — the Food Service and Franchising Group — benefitted from the burgeoning trend.

Accounting for the largest portion of America's food expenditures, the supermarket industry experienced minimal growth in unit volume, while Heublein's Grocery Products Group moved ahead at a substantial rate.

Over-all, fiscal 1976 was a year of continuing growth, improved operating efficiencies and the charting of important new directions for Heublein's food operations.

This area of our company's business showed an 11 per cent gain in revenues for the year, increasing to


"It's finger lickin' good"
Kentucky Fried Chicken

$589 million. Operating income rose 15 per cent to $66 million.

It was a particularly noteworthy year for the Food Service and Franchising Group, headquartered in Louisville, Kentucky.

While its basic business, Kentucky Fried Chicken, exhibited on-going strength in its system-wide operations, the most significant development was the announcement at mid-year of a nation-wide expansion of its restaurant operations.

Embracing Kentucky Fried Chicken stores and two new restaurant concepts, the expansion will increase the number of quick service restaurants — both company-owned and franchised — by some 30 per cent over the next three years. Presently, there are nearly 4,300 KFC company-owned and franchised quick service restaurants in the U.S. Of the 1,200 stores to be opened, the majority will be Kentucky Fried Chicken stores.

Several of the new concept stores — H. Salt Seafood Galley and Zantigo Mexican-American restaurants — already were in operation at year's end and performing successfully.

Other aspects of the expansion plan, the outgrowth of more than a year of research and evaluation, include:

— The clustering of new stores — Kentucky Fried Chicken, H. Salt Seafood Galley and Zantigo restaurants — with existing facilities in heavily-populated U.S. market areas. This will achieve greater economies through the efficiencies of scale.

— Accelerated growth in the number of franchised outlets, including Kentucky Fried Chicken stores, Galley and Zantigo restaurants.

— Franchising approximately 100 existing company-owned Kentucky Fried Chicken stores located outside the designated cluster market areas.

During the second half of the year, a total of 10 new concept restaurants were opened in St. Louis and Memphis. Other units in Minneapolis,

Pittsburgh and Milwaukee were opened earlier.

In fiscal 1977, the company plans to franchise 300 or more quick service restaurants, about evenly divided between new concept restaurants and Kentucky Fried Chicken stores. Additionally, it expects to open some 75 company-owned stores, about equally divided between Kentucky Fried Chicken, Galley and Zantigo.

The total of company-owned KFC stores remained steady at 920 this year due, in part, to the fact that new store construction was temporarily halted pending completion of the company's expansion plans. Some new stores were opened, however, replacing the one per cent that normally are closed through attrition.

Management feels its new expansion program will afford the Food Service and Franchising Group several important advantages. It will (1) provide a greater return on the company's investment; (2) increase the quality of earnings; (3) achieve lower operating costs through the economies and efficiencies of operating in cluster market areas; (4) give broader consumer appeal with three types of restaurants; (5) increase per-store sales averages; (6) and provide a higher rate of earnings growth.

Management views this move into new concept restaurants as a separate

but parallel growth opportunity and a supplement to its chicken business.

The great potential of these new concept restaurants is evidenced by the fact that 30 per cent of the new franchisee applications for Galley and Zantigo are from KFC franchisees.

KFC this year reaffirmed its commitment to the continued success and vitality of its major partners in the business — the 670 franchisees who operate some 3,300 quick service restaurants in the U.S. — by formulating a new franchise agreement.

Benefitting from the increasing popularity of chicken as a staple item in the diet of the American consumer, the Spring Valley Farms poultry-producing operation had an exceptionally good year and increased its contributions to the Food Service and Franchising Group's revenues and operating income.

On the retail side of KFC's business, a new low-investment building concept was established for use primarily in urban market areas where property and construction costs may be relatively high. These low-investment units cost about one-fourth less than a traditional KFC unit and vary only in that kitchen and lobby areas are slightly smaller.

In addition, tests were completed and work began this year on the installation of drive-through windows at several Kentucky Fried Chicken stores. Initial results showed about a ten per cent sales volume increase at stores with the new service.

Heublein's Grocery Products Group, based in Hartford, withstood the economic turbulence that stymied much of the supermarket industry — particularly grocery dry packaged goods — and emerged from the year with solid volume gains.

Focusing on the specialty categories where such products as A.1. Sauce, Grey Poupon Dijon Mustard, Ortega Chiles and Sauces and Regina Wine Vinegars hold positions of leadership,

the Group was able to avoid much of the consumer price resistance encountered by many grocery items. As flavor enhancers, the Group's products benefitted from the consumer's desire to try a broader range of new foods.

A.1. Sauce added to its growth and, despite increased competitive activity in the meat sauce category, increased both sales volume and share of the meat sauce business to record levels. A major factor was an accelerated volume of advertising support, stressing the product's traditional use as a meat sauce, as well as a recipe ingredient. Despite this increased

marketing cost, A.1.'s profitability continued its upward trend.

Grey Poupon Mustard, Snap-E-Tom Tomato Cocktail, Regina Wine Vinegars, as well as the rolls and biscuits made by Hart's Bakeries Inc., a Grocery Products Group subsidiary, all achieved broader distribution with resulting sales increases.

The rapidly-spreading popularity of Mexican foods provided the Grocery Products Group the opportunity to register some of its most significant growth. While grocery store sales of Mexican foods increased 11 per cent nationally this year, Heublein's business — chiles, sauces and taco

shells — grew at a rate nearly twice the category as a whole.

In the western part of the U.S., where Mexican foods have long been part of the regular eating habits of consumers, Ortega brands are market leaders. These well-known brands performed extremely well as the economy of the region recovered from the depressed levels of a year earlier. A unique advertising and merchandising program for chiles — the first of its kind in the industry — tested the use of green chiles on high volume, non-traditional dishes such as grilled cheese sandwiches and hamburgers. The campaign met with highly-favorable consumer response and resulted in a substantial volume sales gain for Ortega.

Ortega went national for the first time with the successful conversion of Zapata taco products (acquired from Zapata Foods in 1974) to the Ortega brand name. Distribution was expanded to include all states east of the Rockies and by the end of the year, Ortega Tacos became one of the nation's largest-selling brands.

The Grocery Products Group emerged from the year with solid volume gains.

With its solid growth this year, and its long-range marketing objectives, the Grocery Products Group now is positioned to benefit from broader and more efficient production capabilities.

The group's new processing plant at Oxnard, California, began production in June.

The Ortega Tacos production facility at Stoughton, Wisconsin, near Madison, was doubled in capacity with new and more automated equipment, as well as additional warehousing and shipping facilities.

Rules for success no secret, say KFC Franchisees

Colonel Sanders' original recipe of 11 herbs and spices may be a secret, but to franchisees the successful operation of a Kentucky Fried Chicken store is an open book.

"We always try to look at things through the customer's eyes," says Bob Thorstenson.

"You just have to keep working at it, day in and day out," adds George Frey.

While their businesses are miles apart — geographically as well as in scope — Thorstenson and Frey have much in common with the 650 other franchisees who own and operate 3,187 of the nation's 4,107 Kentucky Fried Chicken stores.

For the most part, franchisees are small, independent businessmen who have been with KFC for about 10 years. They are successful, hard working, happy at what they're doing and enjoy the good life, both on and off the job.

Thorstenson, 41, is the operating head of a chain of 23 KFC stores, all but two of which are in Illinois. On the other hand, Frey, 67, operates a single

KFC franchisees Bob Thorstenson (top photo, with glasses) and George Frey (bottom photo) chat with customers. Thorstenson, a multiple-store owner, and Frey, who has just one store, both say friendly service is key to success in the KFC business.
Photo on opposite page is Frey's store in Shelbyville, Tenn.

KFC store in Shelbyville, Tennessee.

Despite the size difference in their operations, and the fact that they've never met, their approach to business is surprisingly similar.

Thorstenson, who regularly visits each of the 23 stores in his chain, moves into action immediately if he spots any sign of disorder — an occasional messy table, or even a burned-out light bulb. He sums up his philosophy this way:

"I'm always asking myself, 'Are the stores clean and attractive? Is the service quick and friendly? Is the product top quality?' There's nothing new or startling about that, but it's what I expect when I go shopping and it's what we must provide for our customers."

Frey, with only one store, takes the same approach.

"In the food business, you've got to have quality merchandise," he says. "There's no question about that, plus your store has to be clean and you've got to be friendly to the customers."

Thorstenson and Frey came into the Kentucky Fried Chicken business from different directions. Thorstenson originally was a high school teacher, while Frey had been in the restaurant business all his adult life.

In 1964, Thorstenson and three friends — Weaver Healey, John Healey and Bill Cofel — pooled their funds and opened their first KFC store in a former carwash in the town of Rantoul, Illinois.

None of the partners had any experience in the restaurant business, but they were hard workers and eager to learn. Business picked up quickly and within 10 months they opened a second KFC store, in Rockford, Illinois.

They now own and operate 23 KFC stores in 15 cities, and their annual sales-per-store are well above the $270,000 average of all KFC stores. Even during the recent recession, their sales and earnings increased steadily.

Frey already was a successful restauranteur when Colonel Sanders first called on him back in 1956. At the time, Frey and his wife, Frances, were well-known for their roast beef in wine sauce. It was especially popular with vacationers driving through Shelbyville en route to Florida.

The Freys were looking for another unique menu item and they found it in Colonel Sanders' secret recipe chicken. The Colonel taught them his recipe and, in return, they agreed to pay him five cents for every chicken they sold.

Business was good until the late 1960's when a new interstate highway bypassed Shelbyville and drained off the Frey's tourist trade.

"Shelbyville itself was just too small to support the kind of restaurant we had," recalls Frey. "So we closed it in 1969. But I knew that a Kentucky Fried Chicken store could make it and we opened our store that same year."

Frey's single store operation has been successful from the beginning, but he has given little thought to expanding beyond Shelbyville.

"Frances and I like the food business, but we can't be big operators because to us it's a very personal business," he explains. "We know a lot of people here in Shelbyville and they figure if George and Frances fixed the chicken, it's got to be good."

Thorstenson and his partners took a different tack. They were confident they could maintain the high quality and personalized service in a small chain of stores.

"We couldn't have done it entirely on our own, though," Thorstenson notes. "Being franchisees was an important factor. We probably have worked as closely with the parent company as any franchisee. We don't think of the company as bad guys. We may not always agree, but we're always ready to sit down and discuss any problems. The company deals with franchisees all over the country and I'm learning all I can."

Thorstenson rates high in the eyes of his fellow franchisees and in 1975 they elected him to KFC's National Cooperative Advertising Board which puts him in frequent contact with company representatives and franchisees. It's a time-consuming job, but he works hard at it because he enjoys it.

Away from business, Thorstenson relaxes with his family — wife, Diane, and their children, Todd, 9, and Tanya, 7, — at their home in Paxton, Illinois. He also finds time for a regular round of golf, for the Rotary Club, the Masonic Lodge, and the United Fund.

Like the Thorstensons, the Freys also enjoy a comfortable life off the job. Their new ranch-style home is crammed with mementos of their years in the restaurant business, including some 400 cookbooks collected by Frances, a gourmet cook. George relaxes by tending his vegetable garden, by pitching horseshoes or playing badminton.

Thorstenson's attitude toward his business mirrors that of Frey, as well as other franchisees throughout the KFC system.

"It's easy for customers to take their business somewhere else if we don't provide the kind of quality and service they deserve," he says. "It's not possible to stand still in this business. You have to keep moving ahead."

No two franchisees are exactly alike, but in their initiative and willingness to work for success, Bob Thorstenson and George Frey have a lot in common. They also illustrate the depth and diversity of strength that franchisees bring to Heublein's convenience food business.

International Operations

In fiscal year 1976, with the U.S. well on the way to economic recovery, the remainder of the world was a veritable checkerboard of economic instability.

Lifestyles, world-wide, continue to favor the Kentucky Fried Chicken business . . .

It was against this backdrop of lingering world-wide economic dislocation that Heublein's International Group sought to protect and further its dramatic growth of recent years.

Apt testimony to the International

Group's success was a 21 per cent increase in revenues that totaled $235 million for the year and operating income that rose 29 per cent to $24 million.

Underlying this strong performance were the gains made in strengthening the organizational structure and the placement of highly-skilled personnel in key positions to manage its rapid growth.

Conducting business in 107 countries outside the U.S., the International Group today has more than 5,000 employees. Most are foreign nationals based abroad. The Group operates 25 overseas subsidiaries. It derives its revenues and operating income from three main sources — Kentucky Fried Chicken operations in 46 countries; Smirnoff sales through licensees and agents, and its large alcoholic beverage subsidiaries in Brazil. Increased revenues were realized from all three, despite the economic turbulence that buffeted business strategies virtually on a country-by-country basis.

Kentucky Fried Chicken revenues were up substantially, reflecting the rapidly-increasing universal popularity of chicken. Gains were also achieved in licensee revenues from sales of Smirnoff. The Brazilian subsidiaries, burdened by a combination of new retail-level sales taxes, skyrocketing interest rates and exchange losses, as well as runaway inflation in that country, still managed to finish the year with increased revenues and income.

Lifestyles, world-wide, continue to favor the Kentucky Fried Chicken business as more and more consumers seek casual, leisure living and eat more meals outside the home.

Capitalizing on this trend, the International Group strengthened its position in key markets. KFC business in Australia, already a large market for quick service restaurants, continued to increase substantially as it did in Mexico, Japan and elsewhere.

Anticipating the slower pace of economic recovery overseas, the International Group moved early in the year to emphasize retail merchandising campaigns that stressed the price-value relationship of KFC chicken. This approach, which proved successful from the outset, was quickly rolled across all major markets.

Drawing on the marketing expertise and experience of the domestic KFC business, International integrated many of the same techniques into its own marketing with notable success. These included new product introductions, new retail pack sizes and new promotions that stressed the theme that "Something Good is Always Happening at Kentucky Fried Chicken." Continued stress was placed on quality control, training of store personnel and management development.

Sixty-four retail stores were added to the international system during the year, while the number of countries in which KFC operates was expanded from 39 to 46. The KFC system now operates 780 stores outside the U.S., making it, by far, the largest U.S.-based quick service food system internationally.

Beyond the KFC business, the

International Group is also well represented in Canada with 41 company-owned and franchised H. Salt fish and chips stores. The International Group also began studying application of the Mexican-American Zantigo restaurant concept in a number of countries.

Just as in the U.S., the world-wide consumer preference in alcoholic beverages has made a dramatic shift to lighter drinks, especially those made with vodka. Its skill and experience as America's foremost producer and marketer of vodka gives Heublein a major advantage in world markets.

This was demonstrated this year as Smirnoff increased its case volume by nearly 16 per cent, reinforcing its leadership position in worldwide spirits sales.

Smirnoff increased its world-wide case volume by nearly 16%, reinforcing its leadership position.

These results were achieved in the face of both unstable economic conditions in most countries where Smirnoff is sold and intense pressure from the competition of many other vodka brands.

Yet in market after market, Smirnoff has proved its ability to compete successfully. It is interesting to note that two-thirds of the free world's gross national product outside the U.S. is concentrated in just 12 nations and Smirnoff is the preferred vodka brand in 11 of those 12 countries.

Smirnoff sales were up significantly in the United Kingdom, Canada, Sweden and Norway.

Despite this impressive performance, the world vodka market remains in its formative stage and the growth opportunities still available to Smirnoff and its licensees are manifold. The International Group works closely with its licensees to

Smirnoff sales in Australia and Kentucky Fried Chicken's appeal in New Zealand continue to grow.

develop innovative and effective marketing strategies for the brand. Technical assistance also has been increased to insure Smirnoff's uniform quality in all markets.

Brazilian beverage operations, the third major segment in the International Group's business, increased both revenues and operating income, although a combination of non-operating expenses and certain adverse economic factors weighed heavily on the effort. For example, increased alcoholic beverage taxes in Brazil drove the price of some of the company's liquors from $3.50 a fifth to $7.50 during the year. These heavy taxes also caused gyrations in quarterly shipments and disrupted consumption patterns.

Drury-Fasano, a Heublein subsidiary and Brazil's leading liquor company, still managed to increase sales on all of its more than 20 beverage brands.

The year also saw Drury-Fasano export its first product to the U.S. It was Bahia, a new coffee-based cordial, introduced in the growing U.S. premium cordials market by the Heublein Spirits Group. Initial consumer response in the U.S. has been positive.

Dreher, S.A., Heublein's brandy-producing subsidiary in Brazil, had another outstanding year, increasing case volume by 17 per cent.

Heublein's Portuguese wine operations continued business without disruption during the year, despite continued political uncertainties and rising material costs in that country. While the U.S. continues to be the major importing country for Portuguese wines, market expansion was achieved in several other overseas countries.

Financial Statements

Summary of Accounting Policies

Principles of Consolidation
The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. The Company's investments in affiliated companies (not majority-owned) are accounted for on the equity basis and the Company's operating results include its share of their net income. All significant intercompany transactions are eliminated in consolidation.

Translation of Foreign Currencies
Current assets and liabilities of foreign subsidiaries, except inventories of beverage distilling subsidiaries, are translated into United States dollars at rates of exchange in effect at the balance sheet dates; inventories of beverage distilling subsidiaries and non-current assets and liabilities are translated at rates in effect at the time of the transactions. Revenues and costs and expenses are translated at average rates prevailing during the year, except for depreciation and amortization and cost of sales of beverage distilling subsidiaries which are translated at average rates of exchange in effect when the assets were acquired. Exchange gains and losses are reflected in earnings.

Effective July 1, 1976, the Company will adopt the method of accounting for foreign currency translation as set forth in Statement of Financial Accounting Standards No. 8. Compliance with the retroactive provision of the Statement would have an immaterial effect on fiscal year 1976 and prior years and, accordingly, no restatement will be required.

Inventories
All inventories are stated at the lower of cost or market, cost being determined by the first-in, first-out method, except certain bulk whiskey and wine, the cost of which has been determined by specific lots.

Whiskey and wine in storage for aging over a number of years is included in current assets in accordance with general industry practice.

Property, Plant and Equipment
Depreciation and amortization generally are computed by the straight-line method over the estimated useful lives of the respective assets or the terms of the related leases. On sale or retirement, the asset cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in income. Expenditures which extend the useful lives of assets are capitalized while maintenance and repairs are charged to income as incurred.

Cost in Excess of Net Assets of Purchased Businesses, Trademarks, Contracts and Franchises
Cost in excess of net assets of purchased businesses of $49,465,000 is being amortized over periods ranging from 10 to 40 years. Included is an amount of $12,348,000 not amortized prior to July 1, 1975. The remaining cost of $4,016,000 relating to an acquisition prior to November 1, 1970 is not being amortized as, in the opinion of management, there has been no diminution in value.

Trademarks, contracts and franchises are carried at cost less amortization which is being provided principally on a straight-line basis over periods ranging from 5 to 20 years.

Franchise and License Fees
Initial franchise fees are recorded as income on the date the store is opened by the franchisee. Monthly fees from franchisees and licensees are accrued as earned based on their sales.

Taxes
Deferred income taxes result from timing differences between tax and financial recognition of income and expense. The principal items causing timing differences are provisions for losses on disposition of discontinued operations, accelerated depreciation, and utilization of cash basis accounting for tax and accrual basis accounting for financial reporting for certain subsidiaries.

The investment tax credit is deducted from federal income tax expense in the year in which the related asset is placed in service.

United States and Canadian excise taxes constitute a lien on in-bond inventories. Since these taxes are not payable until withdrawal from bond or after twenty years, whichever is earlier, excise taxes have not been accrued with respect to such inventories in accordance with industry practice.

Pension Plans
The Company has non-contributory retirement plans which cover substantially all full-time domestic employees except certain employees covered by union pension plans. Under collective bargaining agreements, the Company makes contributions to various pension plans for certain union employees. Pension costs charged to current earnings include charges for current service and amortization of prior years' service costs over 30 years. The Company's policy is to fund amounts accrued.

Earnings Per Share
Earnings per common and common equivalent share are based upon (1) the average number of shares of the Company's common stock outstanding during the year, (2) the number of shares issuable on the exercise of dilutive stock options (after reduction for common shares assumed to have been purchased with the proceeds) and (3) the number of shares issuable upon conversion of the outstanding Series B preferred shares.

Earnings per share assuming full dilution are determined on the further assumption that all remaining outstanding dilutive convertible securities were converted as of the beginning of each year, giving effect to the resultant reduction in interest costs net of applicable taxes and that certain additional dilutive stock options were exercised (after reduction for common shares assumed to have been purchased with the proceeds).

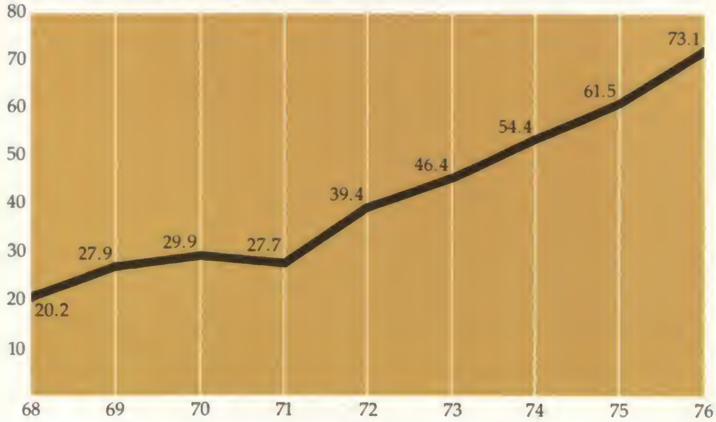
Audit Committee of The Board of Directors
The Audit Committee of the Board of Directors consists of three members who are not officers of the Company. The Committee meets periodically during the year with the Company's financial management and its independent accountants to review internal control procedures and both internal and external audit plans and audit results.

Consolidated Statement of Income

	Year ended June 30, 1976	1975
Revenues:		
Net sales	$1,645,970,000	$1,466,095,000
Franchise and license fees	36,733,000	31,690,000
	1,682,703,000	**1,497,785,000**
Costs and expenses:		
Cost of sales	1,178,905,000	1,066,452,000
Selling, advertising, administrative and general expenses	341,261,000	292,152,000
	1,520,166,000	1,358,604,000
Operating income	162,537,000	139,181,000
Other income (deductions):		
Interest expense:		
Long-term debt	(13,464,000)	(14,038,000)
Other	(5,208,000)	(3,025,000)
Interest income	2,849,000	2,218,000
Miscellaneous—net	(2,688,000)	(726,000)
	(18,511,000)	(15,571,000)
Income before income taxes	144,026,000	123,610,000
Income taxes:		
Federal	55,176,000	50,454,000
State	9,754,000	8,244,000
Foreign	6,003,000	3,416,000
	70,933,000	62,114,000
Net income	**$ 73,093,000**	**$ 61,496,000**
Earnings per share:		
Primary	**$3.39**	**$2.90**
Fully diluted	**$3.27**	**$2.79**

See accompanying notes and summary of accounting policies.

Income-Continuing Operations (IN MILLIONS OF DOLLARS)



Consolidated Balance Sheet

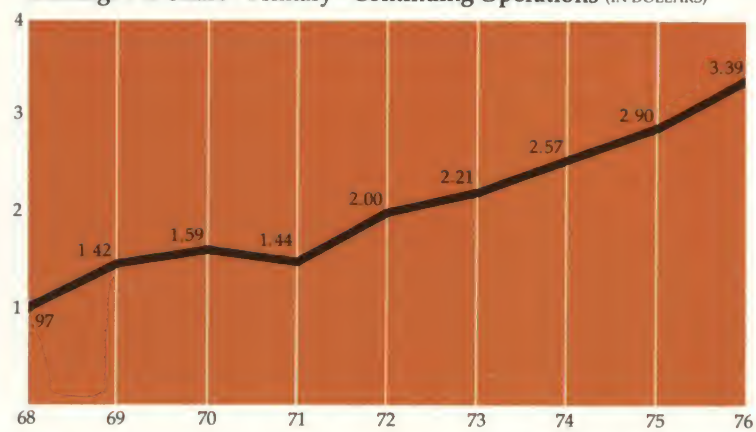
	June 30, 1976	June 30, 1975
ASSETS		
Current assets:		
Cash	$ 18,881,000	$ 25,050,000
Marketable securities, at cost which approximates market	3,000,000	15,379,000
Accounts and notes receivable	221,857,000	172,976,000
Inventories:		
Finished products	72,656,000	65,828,000
Products in process	10,594,000	8,690,000
Bulk whiskey and wine	91,018,000	92,377,000
Raw materials	37,485,000	29,191,000
Total inventories	211,753,000	196,086,000
Prepaid expenses	7,325,000	7,012,000
Total current assets	**462,816,000**	**416,503,000**
Investment in and advances to affiliated companies	**14,579,000**	**4,174,000**
Property, plant and equipment, at cost:		
Land and land improvements	43,343,000	38,496,000
Buildings	104,493,000	91,370,000
Machinery and equipment	173,726,000	152,200,000
Leasehold improvements	42,956,000	40,098,000
	364,518,000	322,164,000
Less accumulated depreciation and amortization	109,960,000	96,294,000
Net property, plant and equipment	**254,558,000**	**225,870,000**
Other assets:		
Properties and other assets not used in continuing operations	10,876,000	12,028,000
Cost in excess of net assets of purchased businesses	53,481,000	54,923,000
Trademarks, contracts and franchises	3,406,000	3,323,000
Deferred income taxes	1,115,000	5,202,000
Other	23,271,000	20,900,000
	92,149,000	**96,376,000**
	$824,102,000	**$742,923,000**

See accompanying notes and summary of accounting policies.

	June 30, 1976	June 30, 1975
LIABILITIES		
Current liabilities:		
Notes payable	$ 29,510,000	$ 11,040,000
Current portion of long-term debt	3,872,000	4,705,000
Accounts payable	60,332,000	46,170,000*
Accrued expenses	47,851,000	38,605,000
Taxes:		
Federal, state and foreign income taxes	26,977,000	49,133,000
Deferred income taxes	8,953,000	4,451,000
Excise taxes	36,485,000	26,028,000
Other taxes	9,597,000	8,379,000
Cash dividends payable	6,395,000	5,857,000
Current portion of reserve for discontinued operations	2,500,000	2,600,000
Total current liabilities	**232,472,000**	**196,968,000**
Long-term debt, due after one year	**201,441,000**	**204,059,000**
Reserve for discontinued operations	**10,490,000**	**12,263,000**
Other long-term liabilities and deferred income	**3,229,000**	**2,179,000**
Minority interest	**3,568,000**	**2,886,000***
SHAREHOLDERS' EQUITY		
Preferred stock	1,940,000	2,649,000
Common stock	10,578,000	10,567,000
Additional paid-in capital	141,973,000	141,256,000
Retained earnings	218,741,000	170,486,000
	373,232,000	324,958,000
Less treasury stock, at cost	330,000	390,000
Total shareholders' equity	**372,902,000**	**324,568,000**
	$824,102,000	**$742,923,000**

See accompanying notes and summary of accounting policies.
*Reclassified to conform to 1976 presentation.

Earnings Per Share - Primary - Continuing Operations (IN DOLLARS)



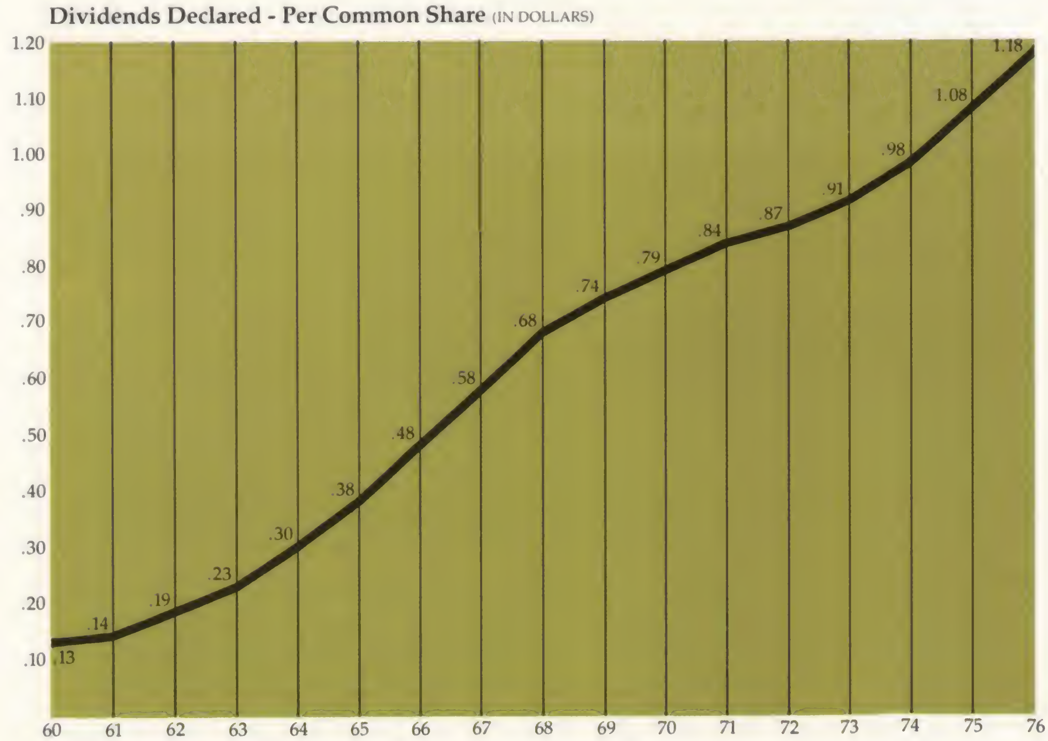
Consolidated Statement of Additional Paid-In Capital

	Year ended June 30, 1976	1975
Balance at beginning of year	**$141,256,000**	**$140,647,000**
Excess of option price over stated value of common stock issued on exercise of options	496,000	233,000
Excess of stated value of preferred stock converted over stated value of common stock	127,000	157,000
Tax benefit from disqualifying dispositions of shares issued under stock option plans	94,000	177,000
Other	—	42,000
Balance at end of year	**$141,973,000**	**$141,256,000**

Consolidated Statement of Retained Earnings

	Year ended June 30, 1976	1975
Balance at beginning of year	**$170,486,000**	**$131,701,000**
Net income	73,093,000	61,496,000
Cash dividends declared on common stock— $1.175 per share ($1.075 in 1975)	(24,838,000)	(22,711,000)
Balance at end of year	**$218,741,000**	**$170,486,000**

See accompanying notes and summary of accounting policies.



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Consolidated Statement of Changes in Financial Position

	Year ended June 30, 1976	1975
SOURCES OF WORKING CAPITAL		
Operations:		
Net income	$ 73,093,000	$ 61,496,000
Charges (credits) not requiring funds:		
Depreciation and amortization	22,357,000	20,036,000
Deferred income taxes	4,087,000	1,345,000
Increase in minority interest	682,000	141,000 *
Equity in earnings of unconsolidated affiliates	(2,919,000)	(1,964,000)*
Funds provided from operations	97,300,000	81,054,000
Book value of assets sold, including properties not used in continuing operations	4,449,000	4,442,000
Increase in long-term debt	1,858,000	102,599,000
Changes in other long-term liabilities and deferred income	1,050,000	(1,302,000)
Proceeds from exercise of stock options	565,000	237,000
Increase in common stock and additional paid-in capital resulting from conversions of preferred stock	129,000	159,000
Tax benefit from disqualifying dispositions of shares issued under stock option plans	94,000	177,000
Other — net	250,000	337,000
	105,695,000	**187,703,000**
USES OF WORKING CAPITAL		
Additions to property, plant and equipment	52,223,000	55,634,000
Cash dividends	24,838,000	22,711,000
Other changes in investment in and advances to affiliated companies	7,557,000	(2,974,000)*
Reduction of long-term debt	4,476,000	94,274,000
Increase in other assets	2,371,000	2,741,000
Reduction of long-term portion of reserve for discontinued operations	1,773,000	4,017,000
Additions to cost in excess of net assets of purchased businesses, trademarks, contracts and franchises	939,000	680,000
Redemptions of series preferred stock	576,000	3,722,000
Conversions of preferred stock	133,000	163,000
	94,886,000	**180,968,000**
Increase in working capital	**$ 10,809,000**	**$ 6,735,000**
CHANGES IN WORKING CAPITAL		
Cash and marketable securities	$ (18,548,000)	$ 10,455,000
Accounts and notes receivable	48,881,000	6,419,000
Inventories	15,667,000	17,541,000
Prepaid expenses	313,000	(983,000)
Notes payable and current portion of long-term debt	(17,637,000)	1,514,000
Accounts payable, accrued expenses and taxes	(17,429,000)	(26,534,000)*
Cash dividends payable	(538,000)	(612,000)
Current portion of reserve for discontinued operations	100,000	(1,065,000)
Increase in working capital	**$ 10,809,000**	**$ 6,735,000**

See accompanying notes and summary of accounting policies.

*Reclassified to conform to 1976 presentation.

Notes to Consolidated Financial Statements

Acquisitions

Investment in and advances to affiliated companies includes $8,310,000 relating to the purchases of 25% interests in two foreign companies during the current fiscal year. The excess of purchase prices over the interests in the net assets acquired, $4,632,000, is being amortized over 40 years. The Company's equity in these operations, which was not material, has been included in the accompanying financial statements from the effective dates of acquisition.

Foreign Subsidiaries

The accompanying consolidated financial statements include the accounts of the Company's foreign subsidiaries as follows:

	1976	1975
Total assets	$166,603,000	$136,927,000
Revenues	219,790,000	179,842,000
Exchange losses	2,964,000	1,703,000
Net income of foreign subsidiaries and equity in earnings of foreign affiliates	9,380,000	6,919,000

Interest expense related to the Company's investment in its foreign subsidiaries, export operations, income from foreign license arrangements and International staff headquarters expense have not been reflected in the net income reported above.

Discontinued Operations

Prior to the Company's acquisition of Kentucky Fried Chicken Corporation (KFC), KFC's management decided to discontinue operating its owned roast beef and domestic fish and chips outlets and three motor hotels. In this connection, provisions for estimated losses of $45,500,000 ($21,750,000 net of tax) were made in prior years. Subsequent operating losses and disposal costs charged against the related reserve aggregate $32,510,000 including $1,873,000 and $2,952,000 in fiscal 1976 and 1975, respectively. Management believes the remaining reserve will be adequate to complete the discontinuance of these operations. Amounts under "Properties and other assets not used in continuing operations" represent assets relating to the Company-owned KFC fish and beef stores.

Inventories

Inventories used in the computation of cost of sales in fiscal 1976 and 1975 were: June 30, 1976 — $211,753,000; June 30, 1975 — $196,086,000; and July 1, 1974 — $178,545,000.

Taxes

The provision for federal income taxes includes deferred tax charges (credits) resulting from the following:

	1976	1975
Excess of tax over book depreciation	$2,508,000	$ 1,594,000
Difference between cash basis accounting for tax and accrual basis accounting for financial reporting for certain subsidiaries	4,502,000	(767,000)
Losses from discontinued operations provided for in prior periods	940,000	2,129,000
Other items	639,000	(2,378,000)
Provision for deferred income taxes	$8,589,000	$ 578,000

The difference between the Company's effective tax rates and the federal statutory rate (48%) is due principally to state income taxes, investment tax credit, and lower foreign rates.

Provision for foreign income taxes is made where applicable. No provision for federal income taxes has been made on the undistributed earnings of foreign subsidiaries since it is management's intent to reinvest substantially all earnings of foreign subsidiaries abroad. The undistributed earnings of foreign subsidiaries for which federal income taxes have not been provided at June 30, 1976 aggregate $20,079,000. If such earnings were distributed, income tax credits would be available to reduce any resulting income tax liability.

Net sales include excise taxes of $400,161,000 in 1976 and $373,581,000 in 1975.

Short-Term Borrowings and Long-Term Debt

Short-term borrowings at June 30, 1976 and 1975 are at weighted average interest rates of 19.2% and 15.8%, respectively. These amounts relate primarily to borrowings of foreign subsidiaries, principally Brazil, amounting to $28,010,000 and $10,852,000 for 1976 and 1975, respectively. Average U.S. and foreign short-term borrowings during fiscal 1976 and 1975 were $23,462,000 and $14,785,000 at weighted average interest rates of 16.7% and 13.7%, respectively. Borrowings reached maximum month-end balances of $30,259,000 and $33,664,000 at April 30, 1976 and December 31, 1974 principally due to foreign working capital needs.

At June 30, 1976 and 1975, the Company had available from several domestic banks informal unsecured lines of credit aggregating $20,000,000 and $17,000,000, respectively, and from foreign banks $19,000,000 and $22,000,000, respectively. In connection with its domestic informal credit lines the Company is expected to maintain average bank balances approximating 10% of the credit lines when not in use and an additional 10% when in use. Such balances are not legally restricted as to utilization or withdrawal and are generally met with normal operating balances.

Long-term debt due after one year follows:

	June 30,	
	1976	1975
4½% convertible subordinated debentures due May 15, 1997	$100,000,000	$100,000,000
8⅜% Notes due February 15, 1985	90,000,000	90,000,000
Mortgage notes payable in various installments	3,991,000	4,129,000
Other	7,450,000	9,930,000
	$ 201,441,000	$204,059,000

The 4½% subordinated debentures are convertible into common stock at approximately $69.50 per share (1,438,800 shares) and are subject to redemption through annual sinking fund payments beginning in 1983 of not less than 6% nor more than 12% of the principal amount of debentures outstanding in 1982.

The 8⅜% Notes may not be redeemed before February 15, 1983. On or after that date, the Notes may be redeemed at the option of the Company in whole or in part at their principal amount, plus accrued interest. Interest is payable semi-annually on February 15 and August 15.

Mortgage notes payable are collateralized by deeds of trust, leasehold improvements, buildings, equipment and other assets with a net carrying amount of approximately $7,800,000 and $10,540,000 at June 30, 1976 and 1975, respectively.

The most restrictive terms of long-term borrowing agreements limit the payment of cash dividends. Consolidated retained earnings not so restricted at June 30, 1976 amounted to approximately $124,000,000.

Aggregate maturities of long-term debt for the next five fiscal years are as follows: 1977 — $3,872,000; 1978 — $2,827,000; 1979 — $1,932,000; 1980 — $1,029,000; and 1981 — $581,000.

Capital Stock

There are 5,000,000 authorized shares of series preferred stock. Changes in outstanding preferred stock during 1976 and 1975 are summarized below:

	Series A Convertible non-dividend stated value $10 per share		Series B Convertible non-dividend stated value $10 per share	
	Shares	Amount	Shares	Amount
Balance at July 1, 1974	1,702,888	$5,212,000	132,239	$1,322,000
Conversions to common stock	(337)	(1,000)	(16,239)	(162,000)
Redemptions (including partial redemptions)	(1,336,617)	(3,042,000)	(68,020)	(680,000)
Balance at June 30, 1975	365,934	2,169,000	47,980	480,000
Conversions to common stock	(218)	(2,000)	(13,116)	(131,000)
Redemptions (including partial redemptions)	(115,128)	(565,000)	(1,092)	(11,000)
Balance at June 30, 1976	250,588	$1,602,000	33,772	$ 338,000

Each Series A preferred share is convertible into .10 share of common stock and is also partially redeemable at the option of the holder at the rate of 1/6 per year after November 1, 1969. Only the last series of partial redemptions reduces the number of shares outstanding. Series B preferred stock is convertible into .2974 share of common stock and is also redeemable in sub series at the rate of 1/5 per year. The Company has the option to redeem both classes in whole or in part for $10 per share beginning November 1, 1976, less any amounts theretofore paid in partial redemption.

Authorized capital stock also includes 500,000 shares of 5% preferred stock, par value $100 per share and 200,500 shares of 5% convertible preferred stock, par value $100 per share, none of which were outstanding during 1976 and 1975.

There are 30,000,000 authorized shares of common stock with a stated value of $.50 per share. The changes in the outstanding shares during 1976 and 1975 are summarized as follows:

	1976		1975	
	Issued	In Treasury	Issued	In Treasury
Shares at beginning of year	21,134,790	9,150	20,993,157	9,150
Shares issued for acquisitions			128,320	
Shares issued upon exercise of stock options	16,432	(1,500)	8,588	
Conversions of preferred shares	3,826		4,725	
Shares at end of year	21,155,048	7,650	21,134,790	9,150

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At June 30, 1976 and 1975, shares of common stock were reserved as follows:

	1976	1975
Conversion of outstanding:		
4½% convertible subordinated debentures	1,438,800	1,438,800
Series A convertible preferred stock	15,761	21,690
Series B convertible preferred stock	10,044	14,269
Stock options	1,502,995	1,522,860
	2,967,600	2,997,619

Stock Options

Options outstanding were granted under the Company's Qualified Stock Option Plan which expired on October 21, 1974, the 1971 Stock Option Plan, and the 1974 Stock Option Plan. In addition, a relatively small number of options granted to employees of acquired companies were assumed by the Company in substitution for options outstanding when the companies were acquired.

The Qualified Stock Option Plan provided for the granting of options for the purchase of 1,000,000 shares at option prices not less than the fair market value of the Company's common stock on the date of grant. The terms of the options did not exceed five years. The 1971 and 1974 Stock Option Plans provide for the granting of options, both qualified and non-qualified, for the purchase of 500,000 and 1,000,000 shares of common stock, respectively, at option prices not less than the fair market value of the Company's common stock on the date of grant. The terms of the qualified and non-qualified options may not exceed five years and ten years, respectively.

Pursuant to an offer by the Company on December 2, 1974, holders of options to purchase 586,025 shares at prices ranging from $36.81 to $64.81 exchanged such options for new non-qualified options to purchase an equal number of shares at $25.38, the average market price on that date.

Changes in options outstanding during the years ended June 30, 1976 and 1975 were as follows:

	1976	1975
Outstanding options at beginning of year	917,510	707,535
Granted, including substitute and exchange options	313,500	927,931
Exercised	(17,932)	(8,588)
Cancelled, including options surrendered in connection with exchange offer	(62,971)	(709,368)
Outstanding options at end of year	1,150,107	917,510

Options exercisable at June 30, 1976 and 1975 aggregate 8,429 and 10,835, respectively.

Information regarding shares which were exercised, became exercisable or were outstanding at each year end is as follows:

	Number of shares	Option price		Market price*	
		Per share	Aggregate	Per share	Aggregate
1976:					
Excercised	17,932	$ 9.66 to 46.44	$ 565,000	$38.69 to 57.31	$ 926,000
Became exercisable	16,184	$23.81 to 64.69	$ 509,000	$38.75 to 50.63	$ 683,000
Outstanding at June 30	1,150,107	$23.81 to 74.07	$36,161,000	$49.75	$57,218,000
1975:					
Exercised	8,588	$ 8.37 to 35.13	$ 236,000	$22.25 to 45.81	$ 321,000
Became exercisable	98,166	$ 8.37 to 64.81	$ 4,659,000	$22.50 to 42.00	$ 3,153,000
Outstanding at June 30	917,510	$ 9.66 to 74.07	$23,101,000	$45.75	$41,976,000

*At dates exercised, became exercisable, or June 30, respectively.

At June 30, 1976 and 1975 there were 352,888 and 605,350 shares, respectively, available for future grant. No charges have been made to income in connection with options granted to date.

Pension and Profit-Sharing Plans

Pension expense was $4,987,000 in 1976 and $3,796,000 in 1975.

Under the Company's profit-sharing plan for salaried employees, the Company's basic contribution is equal to the lesser of 5% of net income, as defined in the Plan, or 5% of participants' salaries plus a supplementary contribution equal to 4% of net income with the limitation of the total contribution equal to 8% of aggregate salaries. Contributions by the Company to the Plan amounted to $3,850,000 in 1976 and $3,151,000 in 1975.

Leases and Commitments

Rent expense charged to operations was as follows:

	1976	1975
Noncapitalized financing leases	$13,554,000	$14,931,000
Other	7,849,000	7,566,000
	$21,403,000	$22,497,000

Aggregate minimum annual rental commitments (excluding payments for real estate taxes, maintenance and insurance, where applicable) under noncancelable leases at June 30, 1976 were as follows:

Fiscal year ending June 30,	Total	Noncapitalized financing leases
1977	$ 14,626,000	$ 12,183,000
1978	13,464,000	11,169,000
1979	11,741,000	9,706,000
1980	10,759,000	8,926,000
1981	10,158,000	8,414,000
1982-1986	37,449,000	31,009,000
1987-1991	19,586,000	16,142,000
1992-1996	8,376,000	7,213,000
Thereafter	17,329,000	17,217,000
	$143,488,000	$121,979,000

Total aggregate minimum noncancelable lease amounts by major plant and equipment category as of June 30, 1976 were as follows:

Land and land improvements	$43,138,000
Buildings	94,938,000
Machinery and equipment	3,556,000
Transportation equipment	1,856,000
	$143,488,000

The present values of the minimum rental commitments for noncapitalized financing leases are summarized below:

	June 30, 1976	June 30, 1975
Land and land improvements	$23,265,000	$25,011,000
Buildings	32,932,000	34,033,000
Machinery and equipment	2,757,000	3,565,000
Transportation equipment	1,575,000	2,043,000
	$60,529,000	$64,652,000

Interest rates implicit in the terms of leases at the time of entering into such leases and used to discount minimum rental commitments for leases range from 5% to 17%. The weighted average interest rate was 10.8% at June 30, 1976 and 1975.

If the Company had capitalized its noncapitalized financing leases and the resultant assets were amortized on a straight-line basis and interest accrued on the outstanding lease liability, the effect on net income in each of the fiscal years ended June 30, 1976 and 1975 would have been less than 3% of average net earnings for the three most recent fiscal years.

Pending Legal Proceedings

In December 1972 the Federal Trade Commission (FTC) filed a complaint alleging a violation of Section 7 of the Clayton Act in connection with Heublein's 1969 acquisition of an 82% interest in United Vintners, Inc., a California winery. In the event FTC counsel are successful in proving a violation of Section 7, they are expected to seek an order requiring divestiture of Heublein's interest in United Vintners and prohibiting for ten years the acquisition of other companies producing or selling domestic wine. A tentative settlement had been reached with FTC staff which was not approved. Further efforts to settle this matter with the FTC by consent agreement have not been successful. It is contemplated that the case will be tried during the winter of 1976-77. Management intends to assert a vigorous defense of the FTC's allegations and believes that the outcome will not have a material adverse effect on the financial condition of Heublein.

In March 1975 Allied Grape Growers (Allied) and eight members of its executive committee filed a complaint against Heublein and certain past and present officers of Heublein and United Vintners, alleging misrepresentation in violation of Federal securities laws and the laws of the State of California in connection with Heublein's acquisition of an 82% interest in United Vintners from Allied. The complaint seeks damages in the amount of $134,400,000 as well as certain injunctive relief, rescission of Heublein's acquisition of an 82% interest in United Vintners and rescission of the long-term grape supply contract between Allied and United Vintners. Heublein intends to conduct a vigorous defense of this litigation. Based upon its present knowledge and assessment of the facts and issues, management believes that the litigation is not likely to result in an award of monetary damages that will have a material adverse effect on the financial condition of Heublein and that the above-referenced request for injunctive relief and rescission will not be granted.

In December 1975 Heublein and United Vintners filed counterclaims against Allied and certain of its directors in which they seek a judgment declaring that the grape supply contract executed by Heublein, United Vintners, and Allied in 1969 is illegal and unenforceable under the antitrust laws, and allege that the plaintiffs and others who are not parties to the action illegally conspired in violation of the antitrust laws to raise the prices which Heublein and United Vintners paid Allied for grapes. The counterclaims seek treble damages and costs suffered by Heublein and United Vintners as a result of the alleged conspiracy. Both Heublein and United Vintners are presently seeking to establish the extent of plaintiffs' liability. It is not yet possible to predict the outcome of the counterclaim, but management believes that any outcome could only have a neutral or positive effect on the financial condition of Heublein.

Between October 1974 and May 1976, 23 purported class action complaints were filed against Heublein and 37 others (including most of the major broiler chicken producers in the United States) which charged the defendants with a conspiracy in the production and sale of broilers in violation of the Sherman Act and claimed that the allegedly unlawful conspiracy has caused plaintiffs and others to be overcharged by an unspecified amount and with respect to an unspecified volume of broiler purchases beginning at least as early as 1970. The complaints do not specify the amount of damages sought, but request that any damages determined to have been sustained as a result of the alleged conspiracy be trebled. The plaintiffs also seek the costs of suit and an injunction against the alleged conspiratorial conduct. Based upon analysis of the facts and issues to date, management believes that the outcome of such litigation will not have a material adverse effect on the financial condition of Heublein.

Heublein is a defendant in various other litigation matters in which aggregate alleged damages are substantial. Based upon the advice of counsel, management believes Heublein has adequate defenses and no material liability will result from such litigation.

Supplementary Income Statement Information

	1976	1975
Taxes, other than income taxes:		
Federal, state and foreign excise taxes	$401,335,000	$374,341,000
Other taxes	21,518,000	17,689,000
	$422,853,000	$392,030,000
Advertising, merchandising and sales promotion	$140,060,000	$115,237,000
Depreciation and amortization	$ 22,357,000	$ 20,036,000
Maintenance and repairs	$ 17,177,000	$ 15,631,000

See "Leases and Commitments" for information on rental expense.

Report of Certified Public Accountants

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

Board of Directors and Shareholders
Heublein, Inc.

We have examined the accompanying consolidated balance sheet of Heublein, Inc. at June 30, 1976 and 1975 and the related consolidated statements of income, additional paid-in capital, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Heublein, Inc. at June 30, 1976 and 1975 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

July 21, 1976

Management's Discussion and Analysis of Consolidated Summary of Operations

The following discussion is presented to explain certain comparative changes shown in the Consolidated Summary of Operations. The Company's accounting policies, consolidated financial statements and notes to consolidated financial statements should be read in conjunction with this discussion since they are all essential in evaluating the Company's results of operations.

1976 Compared to 1975

Revenues increased 12% with each line of business contributing to that increase. Beverage and Food revenues each rose 11% with International rising 21%. Increasing demand for established products and favorable results of new product introductions, particularly Malcolm Hereford's Cows, contributed to the increase. Management estimates that price increases amounted to 2% of revenues.

Cost of sales increased 11% due principally to increased volume, including new product introductions. The easing of inflation and more favorable grape prices helped moderate increasing manufacturing costs.

Selling, advertising, administrative and general expenses rose 17%. This was due primarily to a 22% increase in advertising, merchandising and sales promotion reflecting increased efforts to broaden market share and ensure the successful introduction of new products.

Interest expense reflects a small increase due principally to somewhat higher offshore short-term borrowings to meet working capital needs. Miscellaneous expense increased primarily because of greater foreign exchange losses.

Income taxes reflect the 49.25% rate versus 50.25% in the prior year due primarily to an increase in the investment tax credit and higher foreign earnings with lower effective income taxes thereon.

1975 Compared to 1974

Revenues increased 13%, with all lines of business contributing to the increase. Price increases are estimated to account for approximately 4% of revenues. Revenues of Beverage, Food, and International increased 11%, 13%, and 25%, respectively, as a result of greater demand for established products and the favorable impact of new product introductions.

The percentage increase in cost of sales was slightly higher than the percentage increase in revenues, reflecting, principally, the effects of inflation on raw material and labor and higher energy costs.

Advertising, merchandising and sales promotion increased 9%. Although selling, administrative and general expenses were affected by inflation, with greater volume and aggressive introduction of new products, they were up only 10%.

Interest expense was substantially higher than the prior year due to generally higher interest rates and increased borrowings for capital expenditures and working capital.

The provision for income taxes reflected an effective rate of approximately 50.25% compared to approximately 52.45% in 1974. This reduced rate resulted principally because no provision for federal income taxes was made on the undistributed earnings of Brazilian subsidiaries and increased investment credit.

Consolidated Summary of Operations

Dollars in thousands except per share statistics	1976	1975	1974	1973
REVENUES:				
Beverage	$ 858,706	$ 772,576	$ 697,018	$ 586,423
Food	588,872	530,162	467,875	384,312
International	235,125	195,047	155,852	64,620
	1,682,703	1,497,785	1,320,745	1,035,355
Cost of sales	1,178,905	1,066,452	930,594	719,429
Selling, advertising, administrative and general expenses	341,261	292,152	267,475	213,946
Operating income	$ 162,537	$ 139,181	$ 122,676	$ 101,980
OPERATING INCOME:				
Beverage	$ 72,732	$ 63,226	$ 52,044	$ 42,005
Food	66,059	57,508	54,786	52,707
International	23,746	18,447	15,846	7,268
	162,537	139,181	122,676	101,980
Interest expense	18,672	17,063	9,894	6,357
Interest income	2,849	2,218	1,384	1,683
Other income (deductions) — net	(2,688)	(726)	244	(442)
Income taxes	70,933	62,114	60,000	50,501
Income from continuing operations	73,093	61,496	54,410	46,363
Income (loss) from discontinued operations, less tax effect	—	—	—	(2,152)
Income before extraordinary items	73,093	61,496	54,410	44,211
Extraordinary items	—	—	—	(13,800)
NET INCOME	73,093	61,496	54,410	30,411
Preferred dividends	—	—	—	—
Earnings applicable to common stock	$ 73,093	$ 61,496	$ 54,410	$ 30,411
Common and common equivalent shares	21,536,526	21,216,540	21,166,002	20,932,055
Earnings per common and common equivalent share:				
Continuing operations	$3.39	$2.90	$2.57	$2.21
Discontinued operations	—	—	—	(.10)
Before extraordinary items	3.39	2.90	2.57	2.11
Extraordinary items	—	—	—	(.66)
NET EARNINGS	$3.39	$2.90	$2.57	$1.45
Earnings per common share assuming full dilution:				
Continuing operations	$3.27	$2.79	$2.49	$2.16
Discontinued operations	—	—	—	(.10)
Before extraordinary items	3.27	2.79	2.49	2.06
Extraordinary items	—	—	—	(.61)
NET EARNINGS	$3.27	$2.79	$2.49	$1.45
Cash dividends declared per common share	$ 1.175	$ 1.075	$ .98	$ .91
Common dividends declared	24,838	22,711	20,497	18,095
Earnings retained in the business*	48,255	38,785	33,913	28,268
Taxes of all kinds*	493,786	454,144	423,259	345,510
Capital expenditures	52,223	55,634	59,259	38,954
Depreciation*	19,988	18,303	14,482	10,711
Net property, plant and equipment	254,558	225,870	189,880	148,858
Working capital	230,344	219,535	212,800	124,800
Current ratio	2.0 to 1	2.1 to 1	2.2 to 1	1.8 to 1
Return on shareholders' equity*	21.0%	20.0%	20.1%	19.3%
Income as a percent of revenues*	4.34%	4.11%	4.12%	4.48%
Worldwide employment	24,871	25,912	24,711	18,300
Common shareholders	24,769	27,174	27,493	28,537

Restated where material
*Based on continuing operations

1972	1971	1970	1969	1968
$ 507,125	$ 446,343	$ 398,267	$ 358,081	$ 315,817
325,957	278,869	268,287	227,080	161,433
33,721	19,984	15,751	6,051	3,841
866,803	745,196	682,305	591,212	481,091
595,746	521,682	473,134	414,566	350,899
182,596	156,971	139,186	113,435	86,366
$ 88,461	$ 66,543	$ 69,985	$ 63,211	$ 43,826
$ 39,080	$ 32,491	$ 29,484	$ 26,473	$ 21,969
45,776	31,632	37,817	35,195	20,489
3,605	2,420	2,684	1,543	1,368
88,461	66,543	69,985	63,211	43,826
7,681	8,669	9,149	3,491	2,615
661	396	1,295	274	16
406	(450)	1,610	829	866
42,407	30,151	33,829	32,966	21,891
39,440	27,669	29,912	27,857	20,202
(1,748)	1,514	1,730	3,688	4,616
37,692	29,183	31,642	31,545	24,818
(15,250)	(6,865)	283	—	111
22,442	22,318	31,925	31,545	24,929
293	1,078	1,377	2,733	3,026
$ 22,149	$ 21,240	$ 30,548	$ 28,812	$ 21,903
19,607,538	18,522,645	18,036,939	17,683,913	17,669,663
$2.00	$1.44	$1.59	$1.42	$ .97
(.09)	.08	.10	.21	.26
1.91	1.52	1.69	1.63	1.23
(.78)	(.37)	.01	—	.01
$1.13	$1.15	$1.70	$1.63	$1.24
$1.92	$1.39	$1.51	$1.37	$ .95
(.08)	.07	.08	.19	.24
1.84	1.46	1.59	1.56	1.19
(.73)	(.33)	.01	—	.01
$1.11	$1.13	$1.60	$1.56	$1.20
$ .87	$ .84	$ .79	$ .74	$ .68
15,921	9,554	8,586	7,774	7,012
23,226	17,037	19,949	17,350	10,164
293,844	249,793	237,217	214,810	187,224
30,325	45,086	69,365	34,679	23,610
10,499	9,875	9,779	6,426	6,323
149,052	153,564	155,880	111,840	89,212
147,530	77,035	83,172	47,786	41,339
2.4 to 1	1.6 to 1	1.7 to 1	1.4 to 1	1.4 to 1
19.4%	16.3%	19.4%	19.0%	16.5%
4.55%	3.71%	4.38%	4.71%	4.20%
17,452	16,794	15,693	13,754	13,161
30,044	33,426	29,626	29,586	24,024

Return on Shareholders' Equity

Directors

EDWARD B. BATES[1, 3, 4]
President, Connecticut Mutual Life Insurance Company

CHRISTOPHER W. CARRIUOLO[5]
Executive Vice President

JAMES F. ENGLISH, JR.[1, 3, 4]
Chairman, The Connecticut Bank and Trust Company

PETER M. FRASER
Retired Chairman and President
Connecticut Mutual Life Insurance Company

EDWARD H. HAMM[5]
Vice President, The Northland Company
(A financial service company)

LEON W. HARMAN[5]
President, Harman Management Corporation
(A franchisee for quick-service restaurants)

RALPH A. HART
Consultant and Retired Chairman
Heublein, Inc.

CHARLES G. KLOCK[1, 3, 4]
Retired President, General Electric Credit Corporation

JOHN G. MARTIN[1, 3]
Consultant and Retired Chairman
Heublein, Inc.

ARTHUR A. MILLIGAN[2]
President, Bank of A. Levy

WILLIAM H. MORTENSEN
Personal Investments

FRANCES HEUBLEIN O'DELL
Personal Investments

BARRY M. ROWLES[4]
Vice President - Group Executive

LESTER M. SHIPPEE
Honorary Chairman, The Connecticut Bank and Trust Company

ROBERT L. TRESCHER[1, 2, 3, 5]
Partner, Law Firm of Montgomery, McCracken, Walker & Rhoads

HICKS B. WALDRON[1, 4]
President & Chief Executive Officer

STUART D. WATSON[1, 4]
Chairman of the Board

WILLIAM T. YOUNG[2]
Chairman, Royal Crown Cola Company
President, W. T. Young Storage, Inc.

1. Members of Executive Committee
2. Members of Audit Committee
3. Members of Compensation and Benefit Committee
4. Members of Finance Committee
5. Members of Social Responsibility Committee

Corporate Officers

STUART D. WATSON
Chairman of the Board

HICKS B. WALDRON
President & Chief Executive Officer

CHRISTOPHER W. CARRIUOLO
Executive Vice President

PAUL R. DOHL
Vice President - Group Executive
Spirits Group

MICHAEL A. MILES
Vice President - Group Executive
International Group

JOHN A. POWERS
Vice President - Group Executive
Wines Group

BARRY M. ROWLES
Vice President - Group Executive
Food Service and Franchising Group

ROBERT R. WEISS
Vice President - Group Executive
Grocery Products Group

GEORGE CASPAR
Vice President, Secretary
and General Counsel

GENE R. EHNEN
Vice President and Controller

RICHARD C. FARR
Vice President - Human Resources

J. RICHARD GRIEB
Vice President - Business Strategy Project

CHARLES J. HERBERT
Vice President
President, Spirits Sales Division

JOSEPH M. McGARRY
Vice President
Communication & Public Affairs

JOHN J. MORAN
Vice President and Treasurer

ROY E. STONE
Vice President - Technical Resources

JAMES H. WILLE
Vice President
President, KFC Corporation

Principal Offices

Corporate Headquarters
Farmington, Connecticut 06032 — Code 203 677-4061

Food Service and Franchising Group Headquarters
1441 Gardiner Lane, Louisville, Kentucky 40213 — Code 502 459-8600
KFC Corporation
Retail Venture Company

Grocery Products Group Headquarters
900 Asylum Avenue, Hartford, Connecticut 06105 — Code 203 525-0171

International Group Headquarters
Farmington, Connecticut 06032 — Code 203 677-4061

Spirits Group Headquarters
330 New Park Avenue, Hartford, Connecticut 06101 — Code 203 233-7531
Arrow Sales Company
Smirnoff Sales Company
Venture Sales Company

Wines Group Headquarters
601 Fourth Street, San Francisco, California 94107 — Code 415 421-3213
United Vintners, Inc.

Heublein's 1976 Annual Report on Form 10-K as filed with the Securities and Exchange Commission will be available upon request from the Corporate Secretary, Heublein, Inc., Farmington, Connecticut 06032.

Transfer Agents
The Bank of New York
90 Washington Street, New York, New York 10015
Bank of America, N.T. & S.A.
55 Hawthorne Street, San Francisco, California 94105
Third National Bank in Nashville
Uptown Station, P.O. Box 2844, Nashville, Tennessee 37219

Registrars
Morgan Guaranty Trust Company of New York
30 West Broadway, New York, New York 10015
Wells Fargo Bank, N.A.
475 Sansome Street, San Francisco, California 94111
First American National Bank
326 Union Street, Nashville, Tennessee 37237

Trustees
4½% Convertible Subordinated Debentures
United States Trust Company of New York
45 Wall Street, New York, New York 10005

8⅜% Notes
Morgan Guaranty Trust Company of New York
23 Wall Street, New York, New York 10015

Heublein

HEUBLEIN INC. FARMINGTON CONNECTICUT 06032